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## REGIONAL ECONOMIC DEVELOPMENT: RETHINKING THE REGION

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### ABSTRACT

*The main objective of this article is to determine the factors that contribute to the construction and destruction of regional economic development. Various theories were formulated for the conclusion of this article. Among the theory reviewed was Schumpeterian model (1950) of social inequalities, Borts and Stein (1964) theory of employment change, human capital and social capital theory. A comprehensive conceptual framework of Regional Economic Development was proposed by determining the factors that contribute to regional economic development performance. In attaining regional development, the leadership of the state is proposed to inculcate the Islamic values in administrating and making decision for the development of the region.*

**Keywords:** *economic region, social capital, social inequalities*

### INTRODUCTION

The East Coast Economic Region (ECER) of Malaysia, covering the states of Kelantan, Terengganu, Pahang and the district of Mersing in Johor, is set to become Malaysia's latest and most exciting region offering diverse business opportunities to potential investor. ECER development is expected to become a major trade and industrial gateway, offering investors' access to the vast, burgeoning markets of the Asia Pacific region and beyond, encompassing a vibrant market of about two billion people. ECER has the capability to create the needed mass and demand to propel property development in the region as it can boost the property sector and property prices in the long term. As a long term game, the higher impact would be on industrial development in buildings and land for industrial. However, in addition to creating positive spillover effects to property prices and property development activity in the region, ECER will also create inequalities among the locals and it will deteriorate the land ownership of the Malays in the region as the 'Malay reserve' land will be acquired for the development purposes. Moreover, the stiff competition for business opportunities in the ECER will be a challenge for local entrepreneurs to participate in the ECER development programmes with the arrival of foreign investors to set up business in the east coast states. The diminishing of the Malay's religiosity and values will also be part of the challenge of ECER development program as the spillover of the foreigners' access to the region. This paper thus will discuss the possible implications and needs for ECER development based on the factors suggested by previous researcher to the success of regional economic development. The model proposed in this paper will provide insight for the growth and regional economic development. The model looks at the construction of regions around the theme of development, looking at culture and Islamic values, institutions, social relations and

leadership in the East Coast of Malaysia namely Kelantan, Terengganu, Pahang and the East of Johor, Malaysia.

## **BACKGROUND OF THE STUDY**

In the past, there was a great deal of interest in regional economic development studies among scholars and practitioners alike. Various perspectives were scrutinized. As we see it, there are numbers of theories on regional economic development. It started with Schumpeter's model (1939), focusing on Capitalism and Business cycle followed by the entrepreneurial ability and innovation as a key factor in the process of creative destruction (and construction) of a region. Schumpeterian theory suggests that regional economic development is operable and efficient only when regional social climates are equalized. Following Schumpeter, theory of Borts and Stein (1964) on the other hand focused on the assumption of the labor supply conditions as factors that is invariant between regions. The theory demonstrates that regional development is mainly labor supply driven once we adopt a broader view of elasticity (Mathur, Song, 2000). In contrast, Harry Holzer (1991) and Mathur and Song (2000) claim that employment growth in regional development is labor demand driven due to interregional migration of population and entry of firm. Furthermore, theory of Paasi (1986) concerned with the regional identity and planning emphasizing on social capital formation process and component related to cultural geographers' and sociologist ideas that is crucial for the regional economic development success (Raagma, 2002). Raagma (2002) previously highlighted the issue that, to support social capital formation process, public leaders in regional economic development are the key position in economic peripheries where a general lack of human resources and thin organization exist. The related theory used was named as Chaos theory. According to this theory, leaders have decisive roles during unstable periods or chaos in a society when a very small fluctuation may qualitatively change the direction of development (Raagma 2002).

Recently, new regionalist theories of development emphasis on the significant impact of regional development in relation to changing relationship of territory and function on social construction of regional systems of production, Much emphasis has been put in recent work on the concept of social capital, social mobility and social structure although this is often invoked more than analyzed and often reduced to an inherent cultural trait. This strand of the literature also focuses on the role of networks and trust in economic growth.

However, there is a certain lack of studies addressing the connection and the effects of social capital on other facets of development that can contribute in making growth more sustainable in the long run, like, for example, well being and social cohesion. It is true that economic growth, by increasing total wealth, also enhances its potential for improving well-being and solving other social problems. However, as stated by Schumpeter and the World Bank (2000), 'History offers a number of examples where economic growth was not followed by similar progress in human development. Instead growth was achieved at the cost of greater inequity, higher unemployment, weakened democracy, loss of cultural identity, or over consumption of resources needed by future generation. To be sustainable,

economic growth must be constantly nourished by the fruits of human development. Conversely, slow human development can put an end to fast economic growth' (World Bank, 2000).

Hence, in this article, we attempt to address the theories related to the development of economic region and further will scrutinize the factors contributed to regional economic development. Specifically, we intend to propose the best model to be developed for East Coast Economic Region (ECER) regional development. This issue can be broken down into more specific questions. What is the effect of external economic forces (exogenous factor) on regional and urban development in the East Coast of Malaysia? How does this affect regional culture and values? What are the functions of public leaders relative to these factors and values? What is the moderating role of Islamic values among public leaders on the regional development?

## **ECONOMIC REGIONAL DEVELOPMENT THEORIES**

### **Schumpeterian Model**

Schumpeter stated that "capitalism means a scheme of values, and attitude towards life, a civilization – the civilization of inequality". This means that, he believed that the fluctuations essential for the expansion of an economic system inevitably cause inequalities which is the small price to be paid for the economic progress (Leahy and McKee 1972). During the process of economic development, according to Schumpeter, creative destruction occurs which is the essential fact of capitalism. This is the process of Industrial Mutation .... That incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one .... (Schumpeter, 1950).

According to Schumpeter, development takes place when the circular flow in the stationary economy is upset. It occurs particularly in terms of the production function. The latter takes on a new form as innovation appears in the stationary economy. Innovation is a function of the economy in equilibrium with normal profits because the expected gain is large and the cost is minimal. The initial innovation followed by secondary innovations causes the economic system to regenerate itself. But parts of the organic system are destroyed while others are created. Thus some firms grow while others decline, some industries develop while others lag, and perhaps some regions grow while others decline (Leahy and McKee, 1970). These interregional variations are implicit in the Schumpeterian system. Schumpeter states that entrepreneurial ability and innovations do not occur in all industries. Therefore, the equality does not distribute equally all over the industrial field. Therefore, development does not happen harmoniously over time. This is implicit conclusion in Schumpeter that development is not spread evenly among all in the region.

Schumpeter on the other hand highlighted that, in order to secure a change of quality and economic development, the entrepreneur needs a conducive social climate for such change and action. The entrepreneur (new business) engages in deviant behavior in that he changes the existing political, social, and economic conditions. However, this deviant behavior can be either allowed or prevented by the social climate. Thus the entrepreneur needs at least three elements in the social climate. First, the

social climate must be one in which there are no inhibiting political, social or economic situation. Thus, the crucial point is economic development cannot take place if the social climate is not appropriate to the process of creative destruction (and construction). Schumpeter warned against any change in the social innovation in his economic system.

### **Labor Market Base Theory**

The Borts and Stein (BS) (1964) theory of regional economic growth and development has been widely accepted and discussed in regional development literature. This theory discussed on the issues pertaining to regional economic development as measured by employment change. It started with the theory by Roman (1965) which has theoretical roots of Solows (1956) neo-classical model of economic growth proposed that the income growth in the region was from the implication of employment change, stimulated by investment (capital formation) into the region.

The most pertinent issue highlighted within this model is whether regional growth and development is primarily driven by changes in the labor demand or by changes in labor supply (Mathur & Song, 2000). Bort and Stein's (1964) theory assumption leads them to conclude that regional growth is labor supply driven. This follows from their conjecture that the regional labor demand is highly wage elastic and moreover the economic regional development will lead to higher employment needs, therefore the spillover of exogenous employment will occur. However, Mathur and Song (2000) argued that there are two major weaknesses in the BS model. First, their assumption on immigration into the region is exogenous, ignores the direct and indirect interaction effects between immigration and wage changes on labor demand. Second, BS ignores the agglomeration effects of immigration and hence population growth on labor demands. Hence, Mathur and Song (2000) conclude that regional economic development were driven more by changes in labor demand instead of labor supply. They proposed a model of a regional labor market which provides theoretical support to the observed regularity which is that employment growth is primarily labor demand driven.

### **Social Capital Theory**

Social capital is about the value of social networks, bonding similar people and bridging between diverse people, with norms of reciprocity (Dekker and Uslaner 2001; Uslaner 2001). Sander (2002,) stated that 'the folk wisdom that more people get their jobs from whom they know, rather than what they know, turns out to be true'. Adler and Kwon (2002) identified that the core intuition guiding social capital research is that the goodwill that others have toward us is a valuable resource. As such they define social capital as 'the goodwill available to individuals or groups. Its source lies in the structure and content of the actor's social relations. Its effects flow from the information, influence, and solidarity it makes available to the actor' (Adler and Kwon, 2002). Dekker and Uslaner (2001) posited that social capital is fundamentally about how people interact with each other. Nevertheless, the idea that a region whose inhabitants have a lot of social capital will on the whole perform better. Social capital implies many social links, some of which may transmit valuable information. Relevant information is often costly, and the ones who have easier access to it may have a decisive advantage.

Because knowledge is increasingly specialized and fragmented, having information about new technologies, potential demand, or matching partners can be essential for regional development.

Social capital relations to regional economic development have become a critical term in the social sciences since Loury's (1977) and Coleman's (1988) seminal studies. Coleman (1990) and Putnan, Leonardi, and Nanetti (1993) focus on the positive spillover effect of social capital. The original work from Loury defines social capital as "naturally occurring social relationships among persons which promote or assist the acquisition of skills and traits valued in the marketplace . . . an asset which may be as significant as financial bequests in accounting for the maintenance of inequality in our society' (Loury, 1992)" Penner (1997) on the other hand added that social capital will effect the economic growth as he said social capital is 'the web of social relationships that influences individual behavior and thereby affects economic growth' (Penner 1997). Lin (2001) looking at both operational and strategic development defines Social Capital as 'resources embedded in a social structure, which are accessed/mobilized in purposive actions'. According to this definition, social capital does not consist in social networks per se, but in the resources that these networks may give access to, such as norms, values and trust of social structure. Lin's argument was supported by Fukuyama (1997). He argues that only certain shared norms and values can be regarded as social capital. In addition, Putnan(2000), Ostrom (2000), and Bowles and Gintis (2002) highlighted that trust is central to social capital. Arrow (1972) and Fukuyama (1995) have argued that the level of trust in a society strongly influences its economic performance.

### **Regional Public Leader**

Social capital theory is also embedded in the regional cultural change theory (Dicken, 1998) which is incorporated in social capital norms, trust and values. Changes in culture appear through the process by which institutions are created and modified. New values and identities are thus obtained. As the economy has grown in size, cultural capital has increased too and created more and more different social forms in society. 'Horizontal' cultural and regional-local fragmentation takes place simultaneously with 'vertical' economic globalization and standardization within the so-called global village (Dicken, 1998). Many institutions that are locked into routine practices (Malmberg & Maskell, 1996) and lack innovation may damage positive developments and establish a negative milieu and image with its own people and investors abroad. Economic and social problems due to high unemployment and cultural decline may develop. The problem occurs when the marginal groups seldom win in the normal democratic process and get authority to carry out respective changes. Hence, the quality of the leader matters. Kotter (1996) argues that in the turbulent, fast-changing environment, not just plain old management (planning) was required. Current business literature stresses quite extensively the importance of strategic leadership (see further Kotter, 1988, 1996; Bennis 1994). Public leaders and key persons have been mentioned more often in regional and micro-level economic studies literature (Rokkan & Urwin, 1983; Paasi, 1986a, 1986b, 1996) that potentially contributes to the success of regional economic development.

Applying the leader approach in regional development, we have substantial support from Paasi (1986b) who regards leadership as a precondition for the formation of human groupings. Public leaders in regional economic development are a key position in economic peripheries where a general lack of human resources and thin organization exist. The related theory used was name as Chaos theory. According to this theory, leaders have decisive roles during unstable periods or chaos in a society when a very small fluctuation may qualitatively change the direction of development (Raagma, 2002). Therefore, they are ethical activists of maintaining or alleviating change.

### **Islamic values**

This model will also incorporate Islamic values as the moderator to the public leadership variable. Public leadership should inculcate Islamic values in their administration and decision making related to public welfare. Leaders, who are guided by the Islamic values, have passion to follow the divine path in their daily works. By embedding the Islamic values in public leadership, public leaders promote the norm that is not averse to worldly gain but at the same time ensuring distribution of wealth remain fair to every member of the society, and most importantly, 'the amanah' (trustworthiness) view of wealth is not violated. This amanah seeks to convert the material ambitions of man into attaining spiritual height as his destination in life. More importantly, Islam views conversion of wealth as benevolence through 'infaq' (donation) and 'zakah' (paying alm) or spending in the way of Allah (Hasan, 1995). Through 'infaq' and 'zakah', public leaders would be able to distribute wealth of the state or region fairly among its citizen, whether moslem or non-moslem. Since fairness and justice are experienced by public, stability of the state or region will be attained and development will occur.

The public leaders will gain full trust from the stakeholders and the leaders will become the stakeholders' trustee. In whatever action or decision undertaken, priority in making decision by leader must consider the implication that public or stakeholders will face later (Beekun & Badawi, 1999). In conclusion, Islamic values which are derived from the main sources of Quran and Sunnah, combined with the Islamic culture that blends well with the local malay culture can lead to better leadership strategy and higher regional development.

### **Theory of Human Capital**

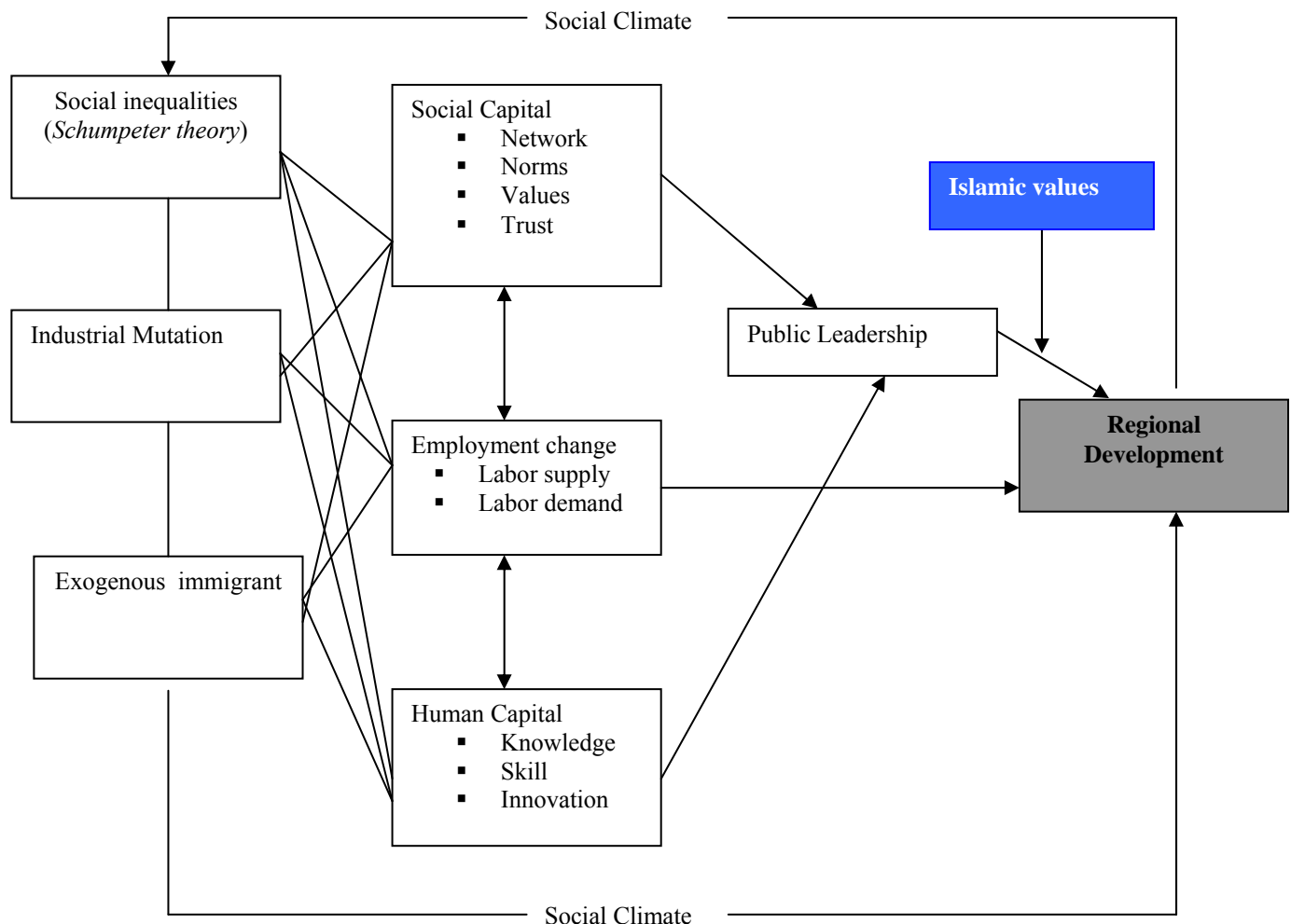
Drennan (2005), Glaeser and Saiz (2004), Simon and Nardinelli (2002), Simon(1998), Glaeser, Scheinkman, and Shleifer(1995), Carihfield and Panggabean (1995) and Rauch (1993) examine determinants of growth for regional development and find that human capital has a powerful impact on economic performance, as measured by population, employment, and income growth, as well as on productivity. This suggests that state and local economic development officials should focus their efforts on encouraging education and retaining and attracting better educated residents. This is supported by Hammond and Thompson's(2008) research on the human capital investment among metropolitan and non- metropolitan areas. They found that human capital investment has a stronger impact on income growth in metropolitan areas than in non- metropolitan areas. In contrast to the large positive impact of human capital investment on growth, we find little correlation between public capital outlays and income growth. This mirror the results reported in the literature for both metropolitan and

non-metropolitan areas and suggest that this type of investment should not be targeted by state and local officials in order to spur economic development. Finally, we find that private physical capital investment in the manufacturing sector encourages per capita income growth in non-metropolitan areas but not in metropolitan areas. This likely reflects the relative decline of one manufacturing in metropolitan areas during the period and the resiliency of manufacturing activity in non-metropolitan areas.

## PROPOSED CONCEPTUAL MODEL OF REGIONAL ECONOMIC DEVELOPMENT

Based on the above theory introduced by previous regionalist on regional economic development, a comprehensive model is proposed. This is due to lack of studies addressing the connection on the effects of all dimensions to the regional economic development. Below is the proposed model of regional economic development.

Figure 1: Conceptual Model of Economic Regional Development



## CONCLUSION

Economic regional development according to the 2008 World Economic and Social Survey, involves economic insecurity which arises from the exposure of individuals, communities and countries to adverse events. It also due to their inability to cope with and recover from the downside losses. The insecurity have been associated with a significant rise in inequality, that is a hollowing out of middle-class lifestyles and reduced welfare protection. On the other hand, economic shocks and premature deindustrialization have raised fears of an insufficiency of the formal sector jobs needed to accommodate an expanding urban population.

These local concerns have been compounded by new global threats. Unregulated financial markets and international capital flows are currently threatening economic livelihoods across the world economy. On the other hand social climate change, imposes the threat of greater local cultural damage and increasingly distort local value and religiosity. Therefore, factors of public leadership as a precondition for the formation of human groupings will be important to hinder or eliviate change. The moderating roles of islamic values in public leadership will enhance the development of the region according to islamic perspectives since majority of inhabitants of ECER are predominantly Malay and Moslem.

The attention brought in this article is to present the significant impact of regional development. Social capital in relation to changing relationship of territory and function on social construction of regional systems of production were brought into attention. Much emphasis has been put in recent work on the concept of social mobility and social structure. Regional economic development were also found to be driven by changes in labor demand and labor supply as well as the human capital. They found that human capital investment has a stronger impact on income growth in the developed region.

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